IT 95-99
Tax Type: INCOME TAX
Issue: Non-Filer (Income Tax)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE	)	
	)	
v.	)	No.
	)	TYE
	)	
TAXPAYER,	)	
	)	
Taxpayer	)	

FINAL ADMINISTRATIVE DECISION

APPEARANCES: Attorneys, for the taxpayer; Mr. Shepard Smith, Special Assistant Attorney General, for the Department of Revenue.

PREFACE: This matter concerns the Illinois corporate income and replacement tax liability of TAXPAYER (hereinafter referred to as the "Taxpayer" or "TAXPAYER") for the taxable years ending September 30, 1988, September 30, 1989 and September 30, 1990 (sometimes referred to as the "Taxable Years"). The Notice of Deficiency issued by the Illinois Department of Revenue (the "Department") proposed, along with an increase in the tax liability for the taxable years, a penalty assessment, pursuant to 35 ILCS 5/1005.

Taxpayer conducts two businesses. The first is its sale of dosimetry services, measuring the amount of radiation in the workplace. The second business is the sale of radon kits which are used to detect radon gas in buildings.

The Administrative Law Judge identified and addressed five issues in this matter. I concur with his recommendation on each issue and adopt his findings in all matters. However, I advance further conclusions as to the issue of whether the taxpayer directly engaged in any income producing

activities outside of Illinois in association with its sales of its dosimetry services sufficient to justify exclusion of such sales from the sales factor numerator of its apportionment formula.

The taxpayer's only facility is located in Illinois. It is at this facility that the dosimetry devices 1) are assembled; 2) are shipped to its customers within and outside of Illinois; 3) are returned for evaluation; and 4) are processed and evaluated with a measurement report written and issued. The only activity which takes place outside of Illinois is the wearing of the device, by customers' employees, for about a one month period of time. As a result of its analysis of these facts, the Department included all dosimetry sales in the taxpayer's sales apportionment numerator.

The Administrative Law Judge concludes that 35 ILCS 5/304(a)(3)(C) governs the analysis of the computation of the numerator of the sales factor in this matter. Specifically, that statutory provision provides, in pertinent part, that:

> (C) Sales, other than sales of tangible personal property, are in this State if:
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> (i) The income-producing activity is performed in this State; or
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> (ii) The income-producing activity is performed both within and without this State and a greater portion of the income-producing activity is performed within this State than without this State, based upon costs of performance.

The Administrative Law Judge concludes that taxpayer's "income producing" activity is conducted within Illinois, therefore, the applicable statutory provision in this matter is 35 ILCS 5/305(a)(3)(C)(i). His reasoning, in which I concur, is that taxpayer's income producing activity is the assembling of and the evaluation of dosimeter film and chips to report to customers the level of radiation at their premises. Toward this end, taxpayer assembles the dosimeters in its Illinois plant from materials

it stores in Illinois. It ships the dosimeters from Illinois. It receives the dosimeters in its Illinois plant where pertinent parts of the dosimeters are analyzed and where the reports to its customers are generated. I assiduously agree with the Administrative Law Judge that the mere wearing of the dosimeter by a customer employee falls into the category of an activity performed on behalf of the taxpayer, and is not an income producing activity pursuant to Department regulation. 86 Ill. Adm. Code ch. I, Sec. 100.3370(c)(3)(A)

However, both the parties herein did an analysis of this issue pursuant to 35 ILCS 5/304(a)(3)(C)(ii), which addresses the computation of the numerator of the sales factor in the apportionment formula if taxpayer's income producing activity is performed both within and without the State. Although the administrative law judge did not address this aspect of the taxpayer's argument, it is significant enough to merit a response. However, even under this analysis, the Department should prevail.

The parties agree that taxpayer's dosimetry service business can be segmented into three parts. They agree that all of the costs incurred in the processing and analysis segment as well as the reporting portion of taxpayer's business are incurred in Illinois. The taxpayer, however, argues that the costs incurred in the "measurement" portion of the business are to be allocated to the State where the dosimetry device is worn and should only be allocated to Illinois if the customer is in Illinois.

This measurement component includes the manufacturing of the dosimeter device and the wearing of the device for the recording of radiation. Yet, all of the components of the device are stored in Illinois and assembled in Illinois. The device is shipped to the customer from Illinois with the majority of taxpayer's customers located outside of this state. All of the costs and the monies expended for the storage, assembly and shipping of the

device are actually expended in Illinois with no dollars actually expended by the taxpayer during that period of time that the device is worn by the customer's employee.

Still, TAXPAYER advances the position that in an analysis of the "costs of performance", the costs attributable to the measurement segment of their service are to be allocated to the state wherein the devices are worn by customer employees. Taxpayer proffers its argument through testimony of its accountant witness. The witness concludes, inter alia, that according to generally accepted accounting principles, the costs incurred for an asset become business expenses at the time and location where the asset is first used for its intended purpose. To reach his conclusion, the witness relies on certain fundamental accounting principles which advise when an asset becomes an expense for accounting purposes.

However, none of the principles cited by the witness, nor any that I am aware of, provide that the asset also becomes an expense where it is first subjected to its intended use. Rather, the witness himself drew the conclusion that the time determined, for accounting purposes, to classify an asset as an expense is also determinative of the location to which the expense is to be allocated.

Although taxpayer's witness so concludes, his testimony is to the contrary. In his testimony, the witness cites Financial Accounting Standards Board, Statement No. 14, par. 10, sec. D, footnote no. 7, in support of his conclusion. But, his testimony is that "it's the nature of the expense, not the geographic location where that cost was incurred, that determines what segment that item should be allocated to." Tr. p. 206.1 Thus, Witness' reliance on this authority to support his conclusion is, by the language on the face of the statement, misplaced. Rather, this statement supports the Department's position that the location when an asset is expensed is not controlling of where the cost of the asset is to

be allocated.

Further, to accept taxpayer's witness' conclusion, and that of the taxpayer itself in this case, leads to an absurd result. Every single dollar actually expended by taxpayer in the transaction of its business is expended in Illinois. No actual costs are incurred in the wearing of the device by persons not employed by the taxpayer as it makes no charge for and gains no income by means of this wearing. Taxpayer's every activity in delivering its service is done in Illinois, from the storage of materials to the assembling of the devices to the shipping of the devices to the processing of the film and the analysis of the information on the film and on the chips to the issuance of its reports, and every dollar expended toward the rendering of this service, which is taxpayer's business, is incurred in and paid from Illinois.

ISSUES: On October 23, 1992, the Department of Revenue issued a Notice of Deficiency to the taxpayer proposing to increase its tax liability in the aggregate sum of $687,272.00, for the three years involved. In addition thereto, a penalty was imposed in the aggregate amount of $93,549.00, pursuant to the provisions of 35 ILCS 5/1005 for failure to timely pay the amount of tax required to be shown on the returns as filed.

Following a timely protest and all pre-trial proceedings, the following issues are posed:

a) Whether the taxpayer directly engaged in any income producing activities outside of Illinois in association with its sales of dosimetry services sufficient to justify exclusion of such sales from the sales factor of its apportionment formula;

b) Whether sales of tangible personal property from Illinois into destination states where taxpayer neither filed a return nor paid a tax should be included in the sales factor numerator of the apportionment

formula;

c) Whether business income from intangibles generated from the investment of excess working capital, royalties and other miscellaneous income resulted from the mere holding of those assets, thereby excluding such income from the sales factor of the apportionment formula;

d) Whether personal property must be utilized exclusively in manufacturing in order to qualify for an investment tax credit;

e) Whether the taxpayer's failure to pay its entire Illinois corporate income and replacement tax liability in a timely manner was due to reasonable cause.

Upon consideration of the matters of record, consisting of both documentary and testimonial evidence, and having weighed the arguments of counsel, it is determined that these questions be resolved as follows:

a) Receipts from the sales of dosimetry services are properly included in the sales factor numerator;

b) Sales of Radon Kits are properly included in the sales factor numerator, with the exception of any sales into the states of Arizona, California, New Jersey, New York and Texas, as well as any sales to the U.S. Government that were included twice in the sales factor numerator;

c) Business income from the intangibles in this case are not properly includable in either the numerator or denominator of the sales factor;

d) The claimed investment tax credit should be partially granted excluding the TLD readers as qualified property in the taxable year ending September 30, 1988 and the TLD and ALNOR readers as qualified property in the taxable year ending September 30, 1989;

e) The proposed penalty under 35 ILCS 5/1005 should be abated in its entirety due to the existence of reasonable cause.

FINDINGS OF FACT:

1. During all times relevant herein, the taxpayer, TAXPAYER, was a corporation organized and existing pursuant to the laws of the State of Delaware, with its principal place of business located in the State of Illinois. (Tr. pp. 74-75)

2. The taxpayer was engaged in two businesses, viz. providing radiation dosimetry services and the sale of radon kits. (Tr. pp. 74-75)

Dosimeters:

3. A dosimeter is a small device for measuring the amount of radiation to which it has been exposed. (Tr. p. 77-78)

4. Dosimetry services consist of providing dosimeters, exposing them to environments which may contain radiation, and the measurement of the amount of radiation to which persons wearing the devices are subjected at their places of employment. (Tr. pp. 77-78)

5. TAXPAYER, provided its customers with dosimeters which were in turn worm by the employees of those customers for a predetermined amount of time. The exposed dosimeters or a part thereof (usually a film packet) would be returned to TAXPAYER's offices where the radiation amounts were measured and a report on the exposure generated. (Tr. pp. 86-89) Once exposed and measured, the film cannot thereafter be utilized for the same purpose. (Tr. pp. 89-90)

6. The dosimeters are assembled in Illinois from purchased components. They are coded in this State with a binary number and the intended wearer's name for the purpose of identification. Records of each film packet are maintained here. The film packets themselves are chemically developed here. The developed film is read, radiation exposure measured and the reports of radiation exposure are all done in Illinois and forwarded to customers within the State and elsewhere. (DOR Ex. 6; Tr. pp. 28-32)

7. In the case of customers located outside of Illinois, the only

contact with them is the exposure of film packets to possible radiation in the workplace for a limited period of time (usually one month). Customers' employees merely wear the dosimeter at their place of employment for that period. TAXPAYER employees are not present at the customer work sites during the wear period, do not otherwise enter the states of non-Illinois customers, and the company does not directly conduct any activity in those states. (Tr. pp. 30-32)

Radon Kits:

8. Radon Kits are devices used to detect Radon gas within buildings. These kits were manufactured by the taxpayer in Illinois and, upon their sale, were shipped from Illinois to destinations throughout the United States and some foreign nations. (Tr. pp. 75-77)

9. For the taxpayer years ending September 30, 1988, through and including September 30, 1990, TAXPAYER filed returns and paid taxes in the states of Arizona, California, New York, New Jersey and Texas. Sales into these states were included in the numerator of the sales factor by the auditor. (DOR Ex. No. 8; Tr. pp. 56-57)

10. For the same period indicated in 9, above, TAXPAYER made sales of Radon kits into the states of Nevada, Wyoming, South Dakota and Washington. None of these four states had imposed an income or franchise tax during the audit period and sales thereto were included in the sales factor numerator of the apportionment formula by the auditor. (TP Ex. No. 9; Tr. p. 57)

11. For the same period indicated in 9, above, and with the exception of Arizona, California, Illinois, New York, New Jersey and Texas, TAXPAYER's only contact with any other state was the presence of its tangible personal property (dosimeter devices) temporarily located therein. (Tr. pp. 145-146)

12. For the taxable period ending September 30, 1990, TAXPAYER made

sales of Radon kits to the U.S. Government in the states of California, New Jersey, New York and Texas. (Tr. p. 51) These sales were included twice in the auditor's computation of the sales factor numerator. (DOR Ex. No. 8; Tr. p. 51)

13. Excepting Arizona, California, Illinois, New Jersey, New York and Texas, no evidence was presented that this taxpayer either filed returns or paid taxes in any other state or foreign country. (TP. Ex. Nos. 9 & 10)

Income From Intangibles:

14. The Department of Revenue included certain business income in the sales factor of the taxpayer's apportionment formula. Those items of income were: a) interest income from the investment of excess working capital; 2) royalty income pursuant to a license which TAXPAYER received when it was spun off from its parent; and 3) miscellaneous income realized from settlement of a patent infringement suit and the recovery of legal fees incurred in an environmental suit. (Tr. pp. 109-113)

15. The only basis for the Department's inclusion of these items of business income was the auditor's determination that such income "occurred in the ordinary, ongoing business activities of TAXPAYER." (Tr. p. 41)

Personal Property Replacement Tax Investment Credit:

16. On its returns for the taxable years involved, TAXPAYER claimed an investment tax credit against its personal property replacement tax liability for certain allegedly qualified property placed in service pursuant to Section 201 of the Income Tax Act. (35 ILCS 5/201)

17. In its Notice of Deficiency, the Department of Revenue had proposed to disallow the entire claimed credit. (Notice of Deficiency)

18. Subsequent to the hearing, TAXPAYER revised the list of property it claimed to be qualified for the credit. (TP Ex. No. 12)

19. The Department has not challenged the revised schedule of qualified property with the exception of TLD and ALNOR readers, both of

which are used to read TLD chips and heat them for reuse. (Tr. pp. 131-138) In each case, the reading of the TLD chips is not a manufacturing function which the heating of the chips is. (Tr. p. 147)

CONCLUSIONS OF LAW:

I. Receipts From Dosimetry Services

The taxpayer is in the business of providing its customers with a report reflecting the amount of radiation to which their employees have been exposed during specific periods of time while present in their respective workplaces. In consideration for such service, the customer pays a subscription fee.

When a taxpayer, such as TAXPAYER, receives income from sales other than sales of tangible personal property, computation of the numerator of the sales factor of its apportionment formula is governed by 35 ILCS 5/304(a)(3)(C), which provides that:

> (C) Sales, other than sales of tangible personal property, are in this State if:
>
> (i) The income-producing activity is performed in this State; or
>
> (II) The income-producing activity is performed both within and without this State and a greater portion of the income-producing activity is performed within this State, based upon costs of performance.

The term "income-producing activity" in the context of sales factor numerator computation is defined by Department Regulation 86 Ill. Admin. Code, Ch. I, Section 100.3370(c)(3)(A), which in pertinent part provides that:

> The term 'income producing activity...' means the transactions and activity directly engaged in by the person in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a person, such as those conducted on its behalf by an independent contractor. (emphasis added)

This regulation clearly and unequivocally interprets the term

"income producing activity" as used in Section 5/304(a)(C)(3) of the Illinois Income Tax Act (35 ILCS 5/304(a)(C)(3)), and as an administrative agency's construction of the law it administers, must be afforded considerable deference. Ford Motor Co. v. NLRB, 441 U.S. 488, 99 S.Ct. 1842 (1979). Moreover, as administrative law judge, I am bound to follow the Department's duly promulgated rules and regulations. Gray Lines Tour Co. of Nevada v. ICC, 824 F.2d 811, 814 (9th Circ. 1987); National Latino Media Coalition v. FCC, 816 F.2d 785, 789 (8th Circ. 1987).

Thus, if the activities engaged in directly by the taxpayer are performed wholly within Illinois, the receipts from such activities are assignable to Illinois and are properly includable in the sales factor numerator of the apportionment formula. If the income producing activities performed directly by TAXPAYER, occur wholly within Illinois, it is unnecessary to engage in a cost performance analysis pursuant to 35 ILCS 5/304(a)(3)(c)(ii), set for above.

The proposed assessment in a Notice of Deficiency is prima facie correct so long as the Department meets some minimum standard of reasonableness in arriving at its proposed adjustments. Vitale v. Illinois Department of Revenue, 118 Ill. App. 3d 210, 454 N.E. 2d 799 (1983). The evidence of record shows no basis by which I could conclude that the proposed assessment fails to meet that minimum standard.

The service which TAXPAYER, provides to its customers and for which it receives payment therefrom is the extraction of information recorded by the customer on the dosimeter or film packet contained therein and the processing of that information into a written report. Those activities and all other activities in which this taxpayer engages in relation to the performance of that service, including the

manufacture of the devices themselves, are performed wholly within the State of Illinois. Merely because some dosimeters are temporarily worn by customer employees outside Illinois and are exposed to ambient radiation during the wear period does not project the income producing activities directly engaged in by the taxpayer outside of this State.

REVERSIONARY SALES OF RADON KITS: If a taxpayer sells tangible personal property to the U.S. Government or sell and ships tangible personal property from Illinois into the state of a purchaser where the taxpayer is not taxable, such sales are included in the sales factor numerator of a taxpayer's apportionment formula. 35 ILCS 5/304(a)(3)(B). Section 3-303(f) of the IITA defines "taxability in another state" as follows:

> (f) Taxability in other state. For purposes of allocation of income pursuant to this Section a taxpayer is taxable in another state if:
>
> (1) In that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
>
> (2) That state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Illinois Income Tax Regulation 100.3200(a) further defines the term "taxable in another state" as follows:

> Further, a taxpayer claiming to be taxable in another state under the tests set forth in (1) must establish not only that under the laws of such state he is subject to one of the specified taxes, but that he, in fact, pays such a tax. If a taxpayer is subject to one of the taxes specified in (1) but does not, in fact, pay such tax, such taxpayer may not claim to be taxable in the state imposing such tax under the test set forth in (2)...(emphasis added)

In sum, Section 3-303(f) of the IITA and Regulation 100.3200(a) provide that if a a jurisdiction has enacted one of the specified types of taxes, then a person must document his payment of that tax in order to be considered "taxable" there. If no such legislation has been enacted, the person must demonstrate that his activities in that jurisdiction exceed

mere solicitation of sales pursuant to 15 U.S.C. 381-384 (Public Law 86-272) in order to be "taxable" in that location.

TAXPAYER, claims that in accordance with Section 3-303(f)(1), it is "taxable" in all states in which it has neither filed a return nor paid a tax (i.e. all states except Arizona, California, Illinois, Nevada, New Jersey, New York, South Dakota, Texas and Washington) because it has tangible personal property in such states which constitute activities in those jurisdictions sufficient to remove the exemption from taxation provided by law.

The evidence of record demonstrates that returns were filed and taxes paid in the states of Arizona, California, Illinois, New Jersey, New York and Texas. Therefore, the sales in those states should not have been "thrown back" into the calculation of the Illinois taxpayers' sales factor numerators and accordingly, such sales should be deducted therefrom.

The auditor initially recommended that the sales of Radon kits into the states of Nevada, South Dakota, Washington and Wyoming should also be "thrown back" into the Illinois taxpayers' sales factor numerator. However, this opinion was subsequently retracted. Notwithstanding, and in conformity with 735 ILCS 5/8-1001 through 1008, commonly known as the Uniform Judicial Notice of Foreign Law Act, I take official notice sua sponte that during 1988 through 1990, none of the four states mentioned above had enacted any of the taxes specified in Section 3-202(f)(1) of the IITA.

Since no income tax was enacted in those states, TAXPAYER, must prove that its activities in each of the four jurisdictions exceeded the mere solicitation of sales in order for it to be considered taxable in those areas. There is no such proof here. The temporary presence of dosimeter devices, which have no relationship to the sales of Radon kits, does not constitute an activity in those jurisdictions sufficient to remove the

exemption from taxation provided by the statute. Thus, sales into those states were properly included in the sales factor of the apportionment formula despite the auditor's opinion to the contrary.

Sales into the remaining jurisdictions must be "thrown back" into the computation of the taxpayer's sales factor numerator unless TAXPAYER, can demonstrate that it filed a return and paid one of the specified taxes. Since it did not, the throwback calculation must remain.

Taxpayer's only arguments against adherence to the payment requirement of regulation 100.3200(a) are a) that it improperly limits the definition of the phrase "taxable in another state" as found in 35 ILCS 5/303(f) and b) that it might subject the taxpayer to double taxation. Yet the terms of the regulation as written are indisputable and I must abide by them. Additionally, acceptance of the potential "double taxation" argument would conflict with the very purpose of Article 3 of the IITA.

The Illinois Supreme Court declared over eighteen years ago in the case of GTE Automatic Electric, Inc. v. Allphin, 68 Ill. 2d 326, 369 N.E. 2d 841 (1977), that the legislative intent and purpose of Article 3 is to:

> ...assure that 100%, and no more or no less, of the business income of a corporation doing multistate business is taxed by states having jurisdiction to tax it.

Having established that premise, the court went on to state that even though Section 3-304(a)(3)(B) of the IITA did not authorize the "throw back" of direct or drop shipment sales (commonly referred to as "double throwback"), the Department had authority to do so under then Section 3-304(e) (now 3-304(f)) of the Act in order to "effectuate the legislative intent of avoiding either an overlap or gap in allocating and apportioning all of the business income from plaintiff's multistate operations". GTE Automatic Electric, supra, at page 339.

The principals announced in GTE, were recently re-emphasized in the case of Dover Corporation v. Department of Revenue, 271 Ill. App. 3d 700,

648 N.E. 2d 1089 (1st Dist. 1995)2. There, as here, where a "double throwback" was not involved, the court found that application of the taxpayer's argument would create a gap in the apportionment of its multistate business income.

Since TAXPAYER, failed to file returns or pay taxes in any states other than the exceptions noted above, such sales necessarily were not included in the sales factor numerators of those states. If TAXPAYER's premise were to be accepted, its sales to all such states would be excluded from the sales factor numerator of any state, thereby creating "nowhere sales" or a gap in the apportionment of its multistate business income. Such a result would directly conflict with the edicts of the GTE and Dover courts on this issue.

Accordingly, with the exception of sales into the states of Arizona, California, New Jersey and Texas, which were incorrectly treated as reversionary sales by the revenue auditor, and sales to the U.S. Government for the tax year ending September 30, 1990, which were included in the sales factor numerator twice, the numerators of the sales factors of the taxpayer were properly computed.

INCOME FROM INTANGIBLES: Pursuant to 86 Ill. Admin. Code, Ch. I, Sec. 100.3380(c)(5), business income derived from intangible personal property cannot be included in the sales factor of a taxpayer's apportionment formula unless such income can be attributed to an income producing activity.

In the course of this proceeding the Department produced no evidence of any income producing activity engaged in by TAXPAYER, to which such income could reasonably be attributed. It is further noted that the intangibles were included in the sales factor solely because the auditor felt them to be of a "business nature", without any other supportive or corroborative information. As such, the adjustments made with respect to

this issue cannot stand. Appropriately, the sales factor numerator and denominator should be reduced by $60,624.00, $491,011.00 and $631,811.00 respectively for tax years 1988, 1989 and 1990.

PERSONAL PROPERTY REPLACEMENT TAX INVESTMENT CREDIT: Illinois law, 35 ILCS 5/201(e), allows a taxpayer to claim a credit against the Personal Property Replacement Tax when it invests in and places in service certain qualified property. The credit is equal to .5% of the basis of any such qualified property placed in service on or after July 1, 1984.

As part of the above statutory section, 35 ILCS 5/201(e)(3) defines the term "manufacturing" to mean:

> ...the material staging and production of tangible personal property by procedures commonly regarded as manufacturing, processing, fabricating or assembling which changes some existing material into new shapes, new qualities or new combinations.

The Department has promulgated regulations interpreting the Investment Credit statute. 86 Ill. Admin. Code, Ch. I, Sec. 100.2100(c)(7), (formerly 100.2900(c)(7)) states in pertinent part:

> In general, in order to qualify for the IITA Section 201(g) [now (e)] investment credit against the replacement tax, property must be used in Illinois by the taxpayer exclusively in manufacturing operations, retailing, coal mining, or fluorite mining...(emphasis added).

The regulation further reiterates the statutory definition of manufacturing but goes on to state at 100.2100(c)(8), (formerly 100.2900(c)(8)):

> ...It is not necessary that such procedures result in a finished consumer product; however such procedures must change some existing material into new shapes, new qualities or new combinations. Procedures commonly regarded as manufacturing, processing, fabrication or assembling are those so regarded by the general public. (emphasis added)

The only assets over which a dispute exists as to their qualification for the credit are the TLD and ALNOR readers. TAXPAYER, has claimed that these readers constitute qualified property because: 1) the regulation does not require that the property's use be exclusively limited to manufacturing; and 2) alternatively , that the reading of TLD chips meets

the statutory and regulatory definition of manufacturing. I cannot accept either of the taxpayer's arguments in this regard.

The regulation is manifest in its requirement that property must be used exclusively in manufacturing in order to qualify for the tax credit. In this vein, the only evidence produced at hearing on whether the TLD reading process constituted manufacturing came from XXXXX, TAXPAYER's vice-president, treasurer and chief financial officer. He admitted in his testimony that the extraction of information from a TLD chip was not a manufacturing function.

It is posed by way of argument, that the testimony of this witness should be given minimal weight as it is that of a lay person. Notwithstanding the fact that it is an admission against interest, the opinion of XXXXX as a lay person is precisely the standard which the regulatory section requires with regard to defining the term. "Manufacturing" procedures are what are commonly thought to be such by members of the general public. If XXXXX does not believe the chip reading process to be manufacturing in the commonly accepted sense, then his opinion should be given the requisite weight due it.

As such, TAXPAYER's claim for personal property tax replacement credit should be granted in part and computed according to Taxpayer's Exhibit 12, entitled "Schedule of Investment Credit Property", with the exception of the TLD readers for the tax year ending September 30, 1988 and both the TLD and ALNOR readers for the tax year ending September 30, 1990.

PENALTY PURSUANT TO 35 ILCS 5/1005: The Department of Revenue has proposed in its Notice of Deficiency that TAXPAYER, should be assessed a penalty pursuant to 35 ILCS 5/1005 for its failure to pay the entire tax liability by the due date. In contradiction, the taxpayer asserts that the penalty should not be assessed because its failure was due to reasonable cause. Reasonable cause is the only basis by which a penalty proposed

under this section may be abated.

The existence of reasonable cause in any particular situation is a factual determination that can only be decided on a case by case basis. Rorabaugh v. United States, 611 F. 2d 211 (7th Circ. 1979). It has generally been interpreted to mean the exercise of ordinary business care and prudence. Dumont Ventilation Company v. Department of Revenue, 99 Ill. App. 3d 263, 425 N.E. 2d 606 (3rd Dist. 1981).

By such standard, this taxpayer has met its burden as to the exercise of ordinary business care and prudence. For the years in question, TAXPAYER relied upon its accounting firm in the preparation of returns and accepted its counseling on the formulation of the apportionment scheme. There is no evidence of record that would lead a reasonable person to conclude that TAXPAYER either abandoned its responsibilities in regard to the preparation of the returns or had cause to suspect that the advice given it was improper. Reliance on experts in the field of taxation in this instance was therefore justifiable.

In consideration of those factors in addition to the complexity of the issues themselves, the lack of available case law, I conclude that the failure to pay taxes properly due in this matter was due to reasonable cause. The penalty proposed under Section 1005 should therefore be abated.

On the basis of the above findings and conclusions, it is determined that the Notice of Deficiency should be affirmed in accord with the revised computations conforming to the administrative law judge's recommendation which are attached hereto and incorporated herein by reference.

Kenneth E. Zehnder
Director of Revenue

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1. This is also the position taken by the Administrative Law Judge, who concluded, essentially, that one must look to the nature of the income producing activity, not the temporary geographic location of an asset, which determines the allocation of income.

2. Certiorari to the Illinois Supreme Court was denied as of September, 1995, with no cite available as of this writing.